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DEPARTMENT FOR E, EUR DAS BRYZA, AND EUR/NCE

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TAGS: [PREL](#) [PGOV](#) [ECON](#) [ENRG](#) [HU](#)
SUBJECT: SCENE-SETTER FOR UNDER SECRETARY JEFFERY'S VISIT
TO HUNGARY

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (C) As Parliament returns from its winter recess, Prime Minister Ferenc Gyurcsany will likely begin 2008 where he ended 2007: with his governing coalition under pressure, his domestic reforms under siege and his foreign policy orientation under question. Your meetings in Budapest will help impress upon Hungarian authorities the importance of staying the course) and staying on message) regarding energy security, particularly by avoiding commitments which would perpetuate a dangerous dependence on GAZPROM.

POLITICAL SURVIVAL AS SUCCESS

¶2. (C) Gyurcsany stumbled early after his surprising electoral victory in April 2006 with the public disclosure of a controversial speech in which he admitted to "lying morning, noon, and night" regarding the state of the economy. Although he weathered major) and often violent) demonstrations in the fall of 2006 and spring of 2007, he has not regained the political initiative and will never fully restore his personal credibility.

¶3. (C) Without them, he has had trouble moving forward on education and health care reform) which will be the subjects of a national referendum on March 9. With his party polling as low as 11 percent and talk of another cabinet reshuffle in the air, he is unlikely to take on the harder challenges of Hungary's pension system and its bloated public sector.

ECONOMIC REFORM: DOING THE RIGHT THING (THE WRONG WAY

¶4. (C) Though many question both his motives and his credentials as a reformer, Gyurcsany is far more progressive than the reformed Communist party he leads. He is often attacked from the left by the opposition leader and by his own rivals within the party as he challenges a paternalistic system that remains heavily dependent on the state.

¶5. (C) To his credit, Gyurcsany correctly identified the imperative of deficit reduction in reversing years of economic irresponsibility by successive governments. His austerity measures have scored impressive successes in reducing Hungary's alarming deficit, but his focus on revenue enhancement rather than structural reform has engendered stagflation: real wages are down more than 6 percent and inflation above 7 percent. Growth indicators are anemic, and questions on transparency and taxation have compounded the concerns of foreign investors regarding Hungary's long-term competitiveness.

FOREIGN POLICY: MYOPIA AND MIXED MESSAGES

¶6. (C) Economic uncertainty and political friction have reinforced Hungary's traditional introversion, and Hungarians

remain ambivalent regarding their role in NATO and increasingly disenchanted with the responsibilities of their membership in the EU. Capitalizing on "islands of consensus," Gyurcsany has used Hungary's deployments in Afghanistan, its efforts to promote a democratic transition in Cuba, and its support for the Ahtisaari plan in Kosovo as proof of his fundamental commitment to "Western values."

¶7. (C) But he will also have to explain Hungary's pursuit of its Eastern interests. Gyurcsany's frequent meetings with Putin, his ambiguous statements on energy security, and his pursuit of a broader and deeper economic relationship with Russia have drawn criticism at home and abroad. Already dependent on Russia as the predominant supplier of its energy resources, Hungary risks long-term economic subservience and political marginalization if it decides to back South Stream. The GoH may be more tempted to do so in light of the political cover provided by the separate accommodations other European capitals have reached with Moscow, and we ask that you hit this point hard.

¶8. (C) Although the PM has expressed his personal frustration with the "misperception" of Hungary's position, even his advisors have admitted that he has made "a vice of necessity" by building a relationship with Moscow that "looks worse than it is." We worked hard over the past months to underscore the risks of drift toward Moscow and focused the government on the strategic consequences of its decisions.

AVERTING DISASTER

¶9. (C) Your meetings come at a critical time. Reports from Ashgabat indicate that Hungarian middlemen are finalizing a contract which would lock in a 30-year obligation to buy Turkmen gas, which would be delivered through existing

GAZPROM-controlled pipelines. This step would undermine both Nabucco and Hungary's sovereignty. Your engagement can help us avert disaster by pressing Hungarian officials to follow through on their stated commitment to diversification of sources and away from GAZPROM-dominated transit. They will have the opportunity to do so by capitalizing on Azeri President Aliyev's upcoming visit to Budapest on February 18-19. Your trip can also encourage Hungary to take a more active leadership role in promoting collective European efforts to meet the challenge posed by Russia.

THE CAST OF CHARACTERS

¶10. (C) We are pursuing meetings with:

The Prime Minister: A Communist Youth Association leader who parlayed his connections into a private fortune in the 1990s and a meteoric political rise thereafter, Gyurcsany is energetic, intense, and often impulsive. These traits make him a good campaigner, but even his supporters have expressed their frustration with a tactical focus and a centralized governing style that often moves "from indecision to imposition." He has been prone to triangulation in his policies and improvisation in his public statements, usually in pursuit of transient political advantage on the home front.

Foreign Minister Kinga Goncz: A surprise appointment at the MFA, Goncz remains largely marginalized from GoH decision-making on key issues including Energy Security. The GoH tends to follow the EU lead on foreign affairs, and Goncz personally tends to strive for "balance" and to value "dialogue." That said, she has been active) but quiet - in reaching out to countries including Qatar, Turkmenistan, and Norway on energy cooperation.

Economy Minister Csaba Kakosy: One of three cabinet ministers from the junior coalition SzDSz party, Kakosy has recently replaced SzDSz Party President Janos Koka, who he served as Chief of Staff. Although he appears committed to continuing the Ministry's support for Nabucco (and for pro-Western initiatives more broadly), he lacks Koka's political power

and is unlikely to wield the same influence over Hungarian policy.

MOL Chair and CEO Zsolt Hernadi: A banker by trade, Hernadi took the helm at MOL in mid-2001, ushering in an era of tightly-controlled management. Reportedly, Hernadi and OTP Bank CEO and MOL Board Member Sandor Csanyi make all strategic decisions at MOL and accept little input from others. With self-professed &excellent relations with both the Government and the opposition) his Foreign Affairs Adviser served in former PM Viktor Orban,s inner circle) Hernadi has remarked that &no energy decisions are made in this country without me.8 However, in contrast to his call for diversification in front of U.S. audiences, Hernadi maintains close ties to GAZPROM and has covered all bets, supporting the Blue Stream extension and Nabucco, and now Nabucco and South Stream. MOL is currently advocating the development of a regional entity to connect and control existing pipelines, thus facilitating North-South transmission of gas.

We also recommend a meeting with representatives of the opposition FIDESZ party, a key player in illuminating the dangers of dependence on Russia and in advocating for Nabucco.

¶11. (U) We look forward to your arrival in Budapest.
FOLEY